Economic Outlook

Irving Trust

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This is an economy of contradictions. The Conference Board's October survey of consumer confidence showed a decline; the University of Michigan's showed a rise. Reports of past and future actions by companies to shrink their payrolls are rife, yet employment is rising at a respectable pace. This is supposed to be a period of "deindustrialization," yet total industrial production has managed to edge upward during the past two years. Some argue the economic expansion will falter next year due to tax reform, an extraordinarily high office vacancy rate, and reduced fiscal stimulus. Similarly, at various times during the past two years it was contended that such problems as an overvalued dollar, an uncompetitive industrial sector, a sorely troubled agricultural economy, and a consumer sector overburdened with debt would cause economic growth to stall. Nevertheless, the economy has continued to expand, although real growth has indeed been below normal. Real GNP has risen at an average annualized rate of 2.5% since the second quarter of 1984 (just before the slowdown began) through the third quarter of this year. With continued improvement in exports as a result of the substantial depreciation of the dollar against major currencies, real GNP growth during 1987 may well exceed this year's estimated rate of 2.7% (on a fourth-quarter to fourth-quarter basis).

The collapse in oil and gas drilling activity has been an important negative factor in the economy's performance this year. The cutbacks in capital spending by the petroleum industry have reduced overall economic growth by six-tenths of a percentage point since the fourth quarter of last year. The oil rig count has been rising for several months now but is still at a painfully depressed level for the industry. If it continues to show gradual improvement, real GNP growth next year will consequently be on a better footing compared to this year. Moreover, the surge in oil imports this year, which pulled down GNP growth by eight-tenths of a percentage point, seems unsustainable. As a result, next year it will be less of a negative influence, although presumably some of the imports this year boosted inventories.

Much concern has been expressed during the last few years about the heavy burden of consumer debt. As of the end of the third quarter, consumer credit outstanding amounted to a record 19.6% of disposable personal income. To a considerable extent, the surge in credit is a mirror image of sustained high levels of auto sales; about 40% of the installment debt outstanding is auto credit. Our forecast and virtually all others call for a decline in auto sales next year. Growth in credit will also slow. In any case, the heavy burden of consumer indebtedness will probably continue to act as a damper on consumer spending but is not likely to precipitate a recession.

In sum, the economy is beset with problems on many fronts, yet so far it has plowed ahead, registering moderate growth. Next year will likely be another year of moderate growth in what we think will prove to be the longest peacetime expansion on record, by a wide margin.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
				1986				1987	1984-	1985-	1986-
	I	II	III	IV	I	II	III	IV	1985	1986	1987
Gross National Product	6.2	2.6	6.4	7.0	7.3	7.7	8.2	7.3	6.2	5.5	7.0
Real GNP	3.8	0.6	2.9	3.8	3.4	4.1	3.8	2.7	2.7	2.7	3.4
GNP Price Deflator	2.5	1.8	3.6	3.1	3.7	3.5	4.2	4.5	3.4	2.8	3.5

	Actual	Forecast	Actual	Forecast	
	1986:III	1986:IV	1984-1985	1985-1986	1986-1987
Consumer Spending	9.7%	1.7%	7.1%	6.1%	6.0%
Durable Goods	45.6	-21.2	8.5	6.6	1.9
Nondurable Goods	1.6	5.9	4.0	3.2	5.9
Services	6.7	6.2	8.9	7.9	7.2
Business Capital Spending	3.1	9.4	10.0	0.9	2.9
Structures	-4.2	8.2	11.1	-6.5	-0.7
Equipment	6.5	9.9	9.4	4.7	4.6
Residential Investment	12.8	11.7	5.7	13.5	8.7
			1985	1986	1987
Change in Inventories	$-8.0b.	$19.0b.	$11.1b.	$17.3b.	$31.9b.
Net Exports of Goods and Services	$-108.2b.	$-107.0b.	$-78.9b.	$-103.4b.	$-84.2b.
			1984-1985	1985-1986	1986-1987
Government Purchases	8.5%	7.3%	11.2%	6.4%	7.2%
Federal	5.7	6.8	13.7	4.1	7.0
Defense	12.2	6.7	10.4	8.2	7.7
Other	-12.4	6.6	24.3	-6.9	4.7
State & Local	10.4	7.7	9.3	8.1	7.4
Corporate Profits Before Tax	5.3*	5.3*	-5.3	5.9	9.5
Corporate Profits After Tax @	-1.1*F	-3.0*	-6.3	-1.6	6.3
Plant and Equipment Expenditures	3.0F	6.0	9.2	-2.0	2.0
Real Final Sales#	5.2	1.6	4.2	2.5	3.2
Real Disposable Personal Income	-2.3	-0.2	2.3	3.3	3.3

Economic Indicators	Recent Data			Actual	Forecast	
	Aug.	Sept.	Oct.	1984-1985	1985-1986	1986-1987
Consumer Price Index**	2.4%	3.6%	2.4%	3.7%	1.7%	4.1%
Producer Price Index for Finished Goods**	3.6	4.8	3.6	2.1	-1.9	3.7
Industrial Production	0.2	0.1	0.0	2.2	1.0	2.3
Retail Sales##	1.4	5.3	-5.0	6.4	5.1	5.2
				1985	1986	1987
Auto Sales (millions of units, a.r.)	12.7	16.1	10.3	11.1	11.4	10.6
Housing Starts (millions of units, a.r.)	1.80	1.65	1.65	1.74	1.83	1.66
Unemployment Rate	6.8%	7.0%	7.0%	7.2%	7.0%	6.6%
Merchandise Trade Deficit (a.r.)	$159.8b.	$150.7b.	$144.7b.	$148.5b.	$166.0b.	$145.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

December 10, 1986

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
$b. = billions a.r. = annual rate F = Forecast

*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
@ Estimated to include loss of investment tax credit beginning in 1986.